

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D51/89

Penalty tax assessments – quantum – long delay by Inland Revenue Department in conduct of enquiries – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Foo Tak Ching and Elsie Leung Oi Sie.

Date of hearing: 1 August 1989.

Date of decision: 14 September 1989.

The taxpayer was the sole proprietor of a business. The Inland Revenue Department made enquiries into the profits of his business commencing in January 1982. The taxpayer provided information to the Inland Revenue Department. Apparently the Inland Revenue Department without further reference to the taxpayer made enquiries of the bankers of the taxpayer and investigated his affairs. It was not until July 1987 that the Inland Revenue Department again contacted the taxpayer. Shortly thereafter, the matter was settled between the Inland Revenue Department and the taxpayer. At the hearing of the appeal, the representative for the Commissioner submitted that the penalty tax assessments imposed were not excessive because the Inland Revenue Department had had to spend a large amount of time to ascertain the true facts and there had been a long delay.

Held:

Penalties in excess of the amount of tax involved were excessive because the long delay had been caused by the Inland Revenue Department itself. No explanation was given as to why there was such a long delay between 1982 and 1987. After the matter was again referred to the taxpayer in 1987, it was speedily resolved. It would not appear that the delay was occasioned by the taxpayer.

Appeal allowed in part.

Yeung Kwai Cheong for the Commissioner of Inland Revenue.

Taxpayer represented by his son.

Decision:

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This is an appeal by a taxpayer against a number of additional tax assessments imposed upon him by the Commissioner under section 82A of the Inland Revenue Ordinance in respect of the years of assessment 1979/80 to 1986/87.

The facts of the case are as follows:

1. The Taxpayer was the sole proprietor of a business which commenced trading in 1952 as a plumbing and electrical installation contractor.
2. The Taxpayer filed tax returns in respect of the years of assessment 1979/80 to 1986/87 inclusive.
3. The Taxpayer was first interviewed by officers of the Inland Revenue Department on 5 January 1982 when he was told that the purpose of the interview was to review his tax affairs. He said in the course of this interview that in his opinion the accounts which he had submitted to the Inland Revenue were correct but he would go back and check their accuracy. He also said that he would call on the Inland Revenue Department again with his son and would submit his bank statements for inspection. During the course of the interview he was asked a number of questions regarding his bank accounts, his assets, and his family and he appears to have answered the same.
4. On 8 January 1982 the Taxpayer called with his son at the Inland Revenue Department and took along the general ledger, the bank book and bank statements for April 1980 and October 1980 to March 1981 for his business. He said that the bank statements from May 1980 to September 1980 had been mislaid. It appeared that the accounts were prepared on a cash basis and only receipts received during a year were included. There was no analysis for stock and work-in-progress. The Taxpayer and his son answered a number of questions with regard to the business accounts. The Taxpayer and his son were asked by the officers of the Inland Revenue Department to provide additional information including a detailed analysis of sub-contractors, a list of contacts being in progress and other similar detailed information.
5. Subsequent to this second interview the Inland Revenue Department issued a number of estimated assessments. Other than the estimated assessments there would appear to have been no further communication from the Inland Revenue Department to the Taxpayer or from the Taxpayer to the Inland Revenue Department other than the filing by the Taxpayer of his tax returns as they were required each year.
6. Apparently unknown to the Taxpayer the officers of the Inland Revenue Department were proceeding to make enquiries of the bankers of the Taxpayer and to investigate his affairs.

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7. The next event was when the Taxpayer's son attended an interview at the Inland Revenue Department on 2 July 1987 at the request of the Inland Revenue Department. The Taxpayer's son was accompanied by a qualified accountant employed by him and he said that he was responsible for operating and managing the accounts of his father's business. He agreed that the accounts which had been submitted to the Inland Revenue Department had been incorrect.
8. On 28 August 1987 the Taxpayer's son submitted to the Inland Revenue Department a set of documents showing an increase in assets held in the names of the Taxpayer and his sons and voluntarily made a payment of \$230,000 by way of deposit to the Inland Revenue Department.
9. After further interviews with the son of the Taxpayer and based on information which appears to have been provided by the son of the Taxpayer, a basis of settlement was reached between the Taxpayer and the Inland Revenue Department. On 31 August 1987 the Taxpayer accompanied by his son attended an interview at the Inland Revenue Department when it was agreed that additional profits of \$2,790,000 had been computed and the Taxpayer agreed to settle his tax affairs on this basis.
10. On 14 September 1988 additional profits tax assessments were issued which took into account the tax which had already been assessed on the returns originally filed by the Taxpayer and the estimated assessments which had been assessed upon him.
11. The following is a table setting out the profits which were returned by the Taxpayer, the profits after investigation, the amount of profit understated, and the amount of tax undercharged:

<u>Year of Assessment</u>	<u>Assessable Profits Before Investigation</u> \$	<u>Assessable Profits After Investigation</u> \$	<u>Profits Understated</u> \$	<u>Tax Undercharged</u> \$
1979/80	61,728	173,728	112,000	24,900
1980/81	71,091	266,091	195,000	40,304
1981/82	82,345	297,345	215,000	43,301
1982/83	147,410	384,410	237,000	40,545
1983/84	318,479	1,043,479	725,000	108,750
1984/85	80,373	763,373	683,000	116,110
1985/86	75,762	209,762	134,000	31,924
1986/87	<u>66,700</u>	<u>555,700</u>	<u>489,000</u>	<u>94,833</u>

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903,888 3,693,888 2,790,000 500,667

12. The Commissioner of Inland Revenue was of the opinion that the Taxpayer had without reasonable excuse made incorrect profits tax returns for the years of assessment 1979/80 to 1986/87 inclusive in respect of his business. On 7 November 1988 he gave notice to the Taxpayer under the terms of section 82A(4) of the Inland Revenue Ordinance that he proposed to assess the Taxpayer to additional tax by way of penalty. The Taxpayer made written representations to the Commissioner. On 29 December 1988 the Commissioner of Inland Revenue, having taken into consideration the representations made by the Taxpayer issued the following additional assessments to tax under section 82A of the Inland Revenue Ordinance:

<u>Year of Assessment</u>	<u>Amount of Additional Tax</u> \$
1979/80	35,400
1980/81	57,300
1981/82	61,500
1982/83	57,300
1983/84	145,800
1984/85	152,300
1985/86	39,500
1986/87	<u>109,400</u>
	<u>658,500</u>

13. The Taxpayer gave notice of appeal against these assessments to additional tax under section 82B of the Inland Revenue Ordinance on 26 January 1989.

At the hearing of the appeal the Taxpayer was represented by his son who said that he and his father had submitted to the Inland Revenue Department all of the documents and information requested by them. He said that he had submitted details of all of the family bank accounts as required by the Inland Revenue Department and had provided a detailed statement of additional assets owned by the Taxpayer, himself and the other sons of the Taxpayer and had deposited with the Commissioner the sum of \$230,000. He admitted that there had been errors in the accounts which had been submitted to the Inland Revenue Department but pointed out that the additional profits tax which had been assessed by the Inland Revenue Department had in fact been based on the information which he had submitted to the Inland Revenue Department when requested in 1987. The Taxpayer's son said that he fully accepted responsibility for the necessity to file correct accounts and returns. He said that he should be responsible for mistakes which he admitted he had made but he considered that the amount of the penalties were excessive in the circumstances. He said that he and his father had no accounting knowledge. The accounts which they had maintained had not been accurate and the result had been that the tax returns which had been

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based on the incorrect accounts were likewise incorrect. He said that he had only been able to make an estimate or guess at the amount to include in the tax returns.

The son further drew our attention to a number of Board of Review decisions in which penalty assessments had been imposed which were substantially less or not more than the amount of the tax undercharged and he submitted that in the present case the amounts of the penalties were excessive.

The representative for the Commissioner said that it had been necessary for the staff of the Inland Revenue Department to spend a large amount of time in this case to ascertain the true facts. He said that it had been necessary for the Inland Revenue Department to investigate not only the bank accounts of the Taxpayer but also the bank accounts of his sons because moneys belonging to the business had been paid into the accounts of the sons as well as the accounts of the Taxpayer. He said that this had meant that the Inland Revenue Department had had to undertake long and extensive enquiries to ascertain the amounts involved. The representative for the Commissioner confirmed that no contact had taken place between the Inland Revenue Department and the Taxpayer or his son after the second interview on 8 January 1982 until the Inland Revenue Department made further enquiries of the son of the Taxpayer in July 1987. He said that the long delay had been caused because of the enquiries which the staff of the Inland Revenue Department were making as he had already explained. The representative for the Commissioner also confirmed that the information provided by the son of the Taxpayer during the interview on 2 July 1987 and following the questions which had been asked at that meeting was the basis on which this case had been settled and that the sum of \$2,790,000 had been computed on information which the son of the Taxpayer had provided.

We are of the opinion that the amounts of the penalties imposed in this case are excessive. We agree with the representative for the Commissioner when he said that the Inland Revenue Department had made detailed and laborious enquiries into this case to ascertain what was the true profit of the business. However we cannot understand why there was such a long delay between the second interview on 8 January 1982 and the further interview on 2 July 1987. Following the interview on 2 July 1987 this entire case was quickly settled and appears to have been settled on the basis of the information provided by the Taxpayer through his son. No doubt the laborious work of the Inland Revenue Department was useful and may have been necessary to verify the information which the Taxpayer provided through his son. However if the Inland Revenue Department had been more open in its enquiries with the Taxpayer and his son in 1982 then presumably this case could have been quickly settled then. The Taxpayer would have known that his accounts were incorrect and would no doubt have modified his accounting system to enquire that in future his accounts were accurate. Because the Inland Revenue Department made enquiries on their own account without reference to the Taxpayer or his son they compounded their own difficulties because as each year went by their problem became greater in finding out what were the true facts. This was pointed out to us by the representative for the Commissioner in his submission. However this appears to have been something which was

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brought on because of the lack of communication between the Inland Revenue Department and the Taxpayer.

It appears to us that a substantial penalty should be imposed upon the Taxpayer for having filed incorrect tax returns and it further appears that an appropriate substantial penalty is an amount equal to the amount of tax undercharged. Accordingly we order that the assessments appealed against which total \$658,500 should be reduced to a total of \$500,667 being the amount of tax undercharged and that each of amounts be reduced as follows:

<u>Year of Assessment</u>	<u>Amount of Penalty Additional Tax imposed by Commissioner</u> \$	<u>Reduced Amount of Penalty Additional Tax as ordered by Board of Review</u> \$
1979/80	35,400	24,900
1980/81	57,300	40,304
1981/82	61,500	43,301
1982/83	57,300	40,545
1983/84	145,800	108,750
1984/85	152,300	116,110
1985/86	39,500	31,924
1986/87	<u>109,400</u>	<u>94,833</u>
	<u>658,500</u>	<u>500,667</u>